

# Tennessee State Funding Board



## Debt Management Policy

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# **Debt Management Policy**

## **Introduction**

Debt management policies provide written guidance about the amount and type of debt issued by governments, the debt issuance process, and the management of the debt portfolio. A debt management policy tailored to the needs of the State of Tennessee (the “State”) and the Tennessee State Funding Board (the “Board”): (1) identifies policy goals and demonstrates a commitment to long-term financial planning, including a multi-year capital plan; (2) improves the quality of decisions concerning debt issuance; and (3) provides justification for the structure of debt issuance. Adherence to its debt management policy signals to rating agencies and the capital markets that the State is well-managed and able to meet its obligations in a timely manner.

Debt levels and their related annual costs are important financial considerations that impact the use of current resources. An effective debt management policy provides guidelines for the State to manage its debt program in line with those resources.

The debt program for the State includes general obligation debt issued by the State for which the State has pledged its full faith and credit for the payment of both principal and interest. The Board is the entity authorized to issue general obligation debt of the State and issues all general obligation debt in the name of the State pursuant to authorization by the General Assembly. The Board is comprised of the Governor, the State Comptroller of the Treasury, the Secretary of the State, the State Treasurer and the Commissioner of Finance and Administration.

The Office of State and Local Finance (the “OSLF”) serves as staff to the Board. Both the Director of the OSLF and the Assistant to the Comptroller for Public Finance serve as the Assistant Secretary to the Board.

## **Goals and Objectives**

The Board is establishing this Debt Management Policy (the “Policy”) as a tool to ensure that financial resources are sufficient to fulfill the State’s long-term capital plan. In addition, this Policy helps to ensure that financings undertaken by the Board satisfy certain clear objective standards designed to protect the State’s financial resources and to meet its long-term capital needs.

### **A. The goals of this Policy**

- To document responsibility for the oversight and management of debt-related transactions;
- To define the criteria for the issuance of debt;
- To define the types of debt approved for use within the constraints established by the General Assembly;
- To define the appropriate uses of debt;
- To define the criteria for the refunding of debt or the use of alternative debt structures; and
- To minimize the cost of issuing and servicing debt.

## **B. The objectives of this Policy**

- To establish clear criteria and promote prudent financial management for the issuance of all debt obligations;
- To identify legal and administrative limitations on the issuance of debt;
- To ensure the legal use of the Board's debt issuance authority;
- To maintain appropriate resources and funding capacity for present and future capital needs;
- To protect and enhance the State's credit rating;
- To evaluate debt issuance options;
- To promote cooperation and coordination with other stakeholders in the financing and delivery of services;
- To manage interest rate exposure and other risks; and
- To comply with Federal Regulations, laws of the state of Tennessee, and generally accepted accounting principles ("GAAP").

## **Debt Management/General**

### **A. Purpose and Use of Debt Issuance**

- Debt is to be issued pursuant to the authority of and in full compliance with provisions, restrictions and limitations of the Constitution and laws of the State (including Title 9, Chapter 9, of the TCA and various bond authorizations enacted by the General Assembly of the State), pursuant to resolutions adopted by the Board.
- Debt may be issued for public purposes of respective State departments and institutions, among others, including without limitation to make grants to counties, metropolitan governments, incorporated towns, cities, special districts of the State, or government agencies or instrumentalities of any of them.
- Debt may be used to finance capital projects authorized by the General Assembly through Bond Acts, included in the Capital Budget and/or approved by the State Building Commission and to fund discount and costs of issuance, limited to 2.5% of the amount allocated in the bond authorizations.
- Debt may be authorized to fund highway improvements. Such authorization is used as a cash management tool and gives budget authority to enter into various contracts for highway capital improvements. The projects are not constructed until the current revenue is available to pay the State's share of the projects. Highway bond authorization is canceled once projects have been funded with current funds.
- Debt may only be used to fund operating expenditures when such debt is repaid in the fiscal year issued.
- Prior to the issuance of bonds, bond anticipation notes may be issued for the payment of costs of projects as authorized by the bond authorization and a resolution of the Board.
- Bonds may be issued to refinance outstanding debt.

## **B. Debt Capacity Assessment**

- The “debt service coverage” test (the “Test”) shall be used to compute the maximum principal amount of bonds that the Board can issue after July 1, 2013. The first step of the Test is to calculate the amount necessary to pay the maximum annual debt service in the then current or any future fiscal year on all outstanding bonds and bonds proposed to be issued (the “Debt Service Amount”). The second and final step of the Test is compare the Debt Service Amount with the amount of total state tax revenue (as defined in Section 9-9-104, of the TCA) that was allocated to the general fund, debt service fund and highway fund for the immediately preceding fiscal year (the “Total Tax Revenue Amount”). If the Debt Service Amount is not greater than ten percent (10%) of the Total Tax Revenue Amount, then the bonds may be issued.
- If the Debt Service Amount is six percent (6%) or more of the Total Tax Revenue Amount, the Board shall cause a debt capacity study to be conducted on an annual basis until the Debt Service Amount drops below six percent (6%) of the Total Tax Revenue Amount.

## **C. Federal Tax Status**

- **Tax-Exempt Debt** – The Board will use its best efforts to maximize the amount of debt sold under this Policy using tax-exempt financing based on the assumptions that tax-exempt interest rates are lower than taxable rates and that the interest savings outweigh the administrative costs, restrictions on use of financed projects, and investment constraints;
- **Taxable Debt** – The Board will sell taxable debt when necessary to finance projects not eligible to be financed with tax-exempt debt. However, the Board may finance taxable projects within the permitted limits of tax-exempt financings whenever possible.

## **D. Legal Limitations on the Use of Debt**

- No debt obligation, except as shall be repaid within the fiscal year of issuance, shall be sold to fund the current operation of any state service or program.
- The proceeds of any debt obligation shall be expended only for the purpose for which it was authorized.
- Debt may only be issued under a bond authorization for which the General Assembly has appropriated sufficient funds to pay the first year’s obligation of principal and interest, and when the Board has determined that such funds are available.
- No debt may be issued for a period longer than the useful life of the capital project it is funding.

## **Types of Debt**

### **A. Bonds**

**Security** – Pursuant to Section 9-9-105, of the TCA, the Board may issue general obligation bonds, which are direct general obligations of the State payable as to both principal and interest from any funds or monies of the State from whatever source derived. The full faith and credit of the State is pledged to the payment of principal of and interest on all general obligations bonds. Subject only to Section 9-9-104(a), all general obligation debt constitutes a charge and lien upon the entire fees,

taxes and other revenues and funds allocated to the general fund, the debt service fund, and the highway fund.

These bonds may be structured as:

- **Fixed Interest Rate Bonds** – Bonds that have an interest rate that remains constant throughout the life of the bond.
  - Serial Bonds
  - Term Bonds
- **Variable Interest Rate Bonds** – Bonds which bear a variable interest rate but do not include any bond which, during the remainder of the term thereof to maturity, bears interest at a fixed rate. Provision as to the calculation or change of variable interest rates shall be included in the authorizing resolution.
- **Capital Appreciation Bonds** – A municipal security on which the investment return on an initial principal amount is reinvested at a stated compounded interest rate until maturity, at which time the investor receives a single payment representing both the initial principal amount and the total investment return.

## **B. Short-Term Debt**

Pending the issuance of the definite bonds authorized by the bond authorizations, the Board may issue short-term debt from time to time as needed to fund projects during the construction phase. Such debt shall be authorized by resolution of the Board. Short-term debt may be used for the following reasons:

- To fund projects with an average useful life of ten years or less. The Board may provide that the short-term debt issued may mature more than five years from the date of issue of the original short-term debt; provided, that an amortization schedule of principal repayment is established for the project funded by the short-term debt and provisions are made such that any short-term debt or renewal of short-term debt or bond refunding such short-term debt attributed to the financing of such project shall be redeemed or retired no later than the useful life of the project and no later than either twenty-five years from the date of such original short-term debt or twenty years from the date the project is completed and placed into full service, whichever is earlier.
- To fund projects during the construction phase of the projects.
- To fund cash flow deficits when repaid in the fiscal year in which the debt was issued.

Typically short-term debt is issued during the construction period to take advantage of the lower short-term interest rates and then refunded with bonds once projects are completed. The short-term debt may be structured as Bond Anticipation Notes (“BANs”) or short-term obligations that will be repaid by proceeds of a subsequent long-term bond issue. The short-term debt may include:

- **Bond Anticipation Notes (“BANs”)** – BANs are short term obligations that will be repaid by proceeds of a subsequent long-term bond issue.
- **Commercial Paper (“CP”)** – CP is a form of BANs that has a maturity up to 270 days, may be rolled to a subsequent maturity date. It can be issued incrementally as funds are needed.
- **Fixed Rate Notes** – Notes issued for a period of time less than three years at a fixed interest rate.



- **Variable Rate Notes** – Notes issued for a period of time less than three years which bear variable interest rates until redeemed. Provision as to the calculation or change of variable interest rates shall be included in the authorizing resolution.
- **Revolving Credit Facility** – A form of BANs involving the extension of a line of credit from a bank. The bank agrees that the revolving credit facility can be drawn upon incrementally as funds are needed. The draws upon the line of credit may bear variable interest rates until redeemed. Provision as to the calculation or change of variable interest rate shall be included in the authorizing credit agreement.
- **Tax and Revenue Anticipation Notes (“TRANS”)** - TRANS are short term notes secured by a pledge of taxes and other general fund revenues in the current fiscal year of the State. TRANS, if issued, will constitute direct obligations of the State backed by the full faith and credit of the State. All TRANS will be redeemed in the same fiscal year in which they are issued.

## **Debt Management Structure**

The Board shall establish by resolution all terms and conditions relating to the issuance of debt and will invest all proceeds pursuant to the terms of the Board’s authorizing resolution and the State’s investment policy.

### **A. Term**

The term of any debt (including refunding debt) used to purchase or otherwise obtain or construct any equipment, goods, or structures shall have a reasonably anticipated lifetime of use equal to or less than the average useful life of the project. The final maturity of the bond debt should be limited to 20 years after the date of issuance or the date the project is deemed complete or placed in service, whichever is earlier unless otherwise permitted by the Bond Act and approved by the Board in the Bond Resolution.

### **B. Debt Service Structure**

Debt issuance shall be planned to achieve level principal over a twenty year period unless otherwise specified in the bond act. The Board shall avoid use of bullet or balloon maturities; this does not include term bonds with mandatory sinking fund requirements.

No debt shall be structured with other than at least equal principal repayment unless such structure is specifically approved by unanimous vote of the members of the Board.

### **C. Call Provisions**

When issuing new debt, the structure may include a call provision that occurs no later than ten years from the date of delivery of the bonds. Call features should be structured to provide the maximum flexibility relative to cost. The Board will avoid the sale of long-term non-callable bonds absent careful evaluation by the Board with respect to the value of the call option.

### **D. Original Issuance Discount/Premium**

Bonds sold with original issuance discount/premium are permitted with the approval of the Board. The Board is authorized to sell bonds in amounts not to exceed 2.5% of the amount stated in the bond act for funding discounts.

## **Refunding Outstanding Debt**

The Board may refinance outstanding bonds by issuing new bonds. The Board and the Board's staff with assistance from the Board's financial advisor (the "Financial Advisor") shall have the responsibility to analyze outstanding bond issues for refunding opportunities. The Financial Advisor will conduct an analysis of all refunding candidates at least semiannually to identify potential refunding candidates from the outstanding bond maturities. The Board will consider the following issues when analyzing possible refunding opportunities:

### **A. Refunding Opportunities**

The bonds will be considered for refunding when:

- In the case of an advance refunding:
  - (1) The refunding results in aggregate present value savings of at least 4% per series of refunding bonds as certified to the Board by the Financial Advisor to the Board, or the option value per maturity of refunded bonds exceeds 70% as certified to the Board by the Financial Advisor to the Board; and
  - (2) the aggregate present value savings must be equal to or greater than twice the cost of issuance allocable to the refunding series.
- In the case of a current refunding:
  - (1) The refunding results in aggregate present value savings of at least [4%] per series of refunding bonds as certified to the Board by the Financial Advisor to the Board; or the aggregate present value savings per series of refunding bonds is no less than [\$1,000,000]; and
  - (2) the aggregate present value savings must be equal to or greater than twice the cost of issuance allocable to the refunding series.

Any of the forgoing requirements for a current refunding can be waived by the Board after consultation with the Financial Advisor.
- The refunding of the bonds is necessary due to a change in the use of a project that would require a change to the tax status of the Bonds; or
- A project is sold while still in its amortization period.

If a decision to refund is based on savings, then the Board will issue the refunding debt only after receipt of a certified analysis from the Financial Advisor that the market conditions at the time of the sale will still accomplish cost savings to the public.

### **Present Value Savings Calculation**

Unless otherwise agreed upon by the Office of State and Local Finance and the Financial Advisor, the present value savings shall be calculated for each series of refunding bonds (whether or not issued at the same time) by (i) comparing the debt service on the refunding bonds to the remaining debt service on the bonds to be refunded thereby, present valued to the issue date of such refunding bonds at a discount rate equal to the arbitrage yield on such refunding bonds calculated (whether for tax-exempt bonds or taxable bonds) in the same manner as arbitrage yield is calculated for Federally tax-exempt bonds; provided, however, if a series of bonds is being issued for the purpose of refunding bonds to be refunded and for other purposes, only the portion of such bonds issued for the purpose of refunding bonds to be refunded (and related allocable costs of issuance) shall be included in such calculations. Percentage present value savings shall be expressed as a percentage of the par amount of such bonds to be refunded.

### **Option Value Calculation**

The Option Value analysis quantifies the projected value of the call option (ability to refund the bonds) in the future, based upon implied forward rates in the present day yield curve. The “efficiency” of a proposed refunding is determined by comparing the present value savings associated with refunding the bonds in the current market relative to the option (future) value associated with the refunded bonds.

### **B. Term of Refunding Issues**

The bonds will have a term not extending beyond the fiscal year of the latest outstanding maturity of the originally issued debt. No backloading of debt will be permitted.

### **C. Bond Structuring**

The bonds will be structured to create proportional or level debt service savings.

### **D. Escrow Structuring**

The Board shall structure refunding escrows using legally permitted securities deemed to be prudent under the circumstances and will endeavor to utilize the least costly securities unless considerations of risk, reliability and convenience dictate otherwise. The Board will take competitive bids on any selected portfolio of securities and will award to the lowest cost provider giving due regard to considerations of risk and reliability or unless State and Local Government Series securities (“SLGS”) are purchased directly from the Federal Government. The provider must guarantee the delivery of securities except for SLGs. Under no circumstances shall an underwriter, agent or financial advisor sell escrow securities to the Board from its own account.

### **E. Arbitrage**

The Board shall take all reasonable steps to optimize escrows and to avoid negative arbitrage in its refunding subject to 9-4-602 and 9-4-603, of the TCA. Any positive arbitrage will be rebated as necessary according to Federal guidelines (see also “Federal Regulatory Compliance and Continuing Disclosure – A. Arbitrage”).

## **Methods of Sale**

Pursuant to Section 9-9-205 and 9-9-207, of the TCA general obligation bonds issued by the Board shall be sold in such manner as may be determined and approved by the Board. Following each sale, the Office of State and Local Finance (“OSLF”) with the assistance of the Financial Advisor shall provide a report to the Board on the results of the sale.

### **A. Competitive Sale**

In a competitive sale, the Board’s bonds are posted for auction sale and awarded to the bidder providing the lowest true interest cost as long as the bid conforms to the requirements set forth in the official notice of sale. The competitive sale is the Board’s preferred method of sale.

### **B. Negotiated Sale**

While the Board prefers the use of a competitive process, the Board recognizes some bonds are best sold through negotiation. The underwriting team will be chosen and the underwriter’s fees negotiated prior to the sale. See section below titled “Selection of Underwriting Team (Negotiated Transaction).” In its consideration of a negotiated sale, the Board will assess the following factors:

- A structure which may require a strong pre-marketing effort such as a complex transaction;
- Volatility of market conditions and whether the Board would be better served by flexibility in timing a sale;
- Size of the bond sale which may limit the number of potential bidders;
- If legal or disclosure issues make it advisable in marketing the bonds;
- Credit strength;
- Whether or not the bonds are issued as variable rate demand obligations, and
- Tax status of the bond.

### **C. Private Placement**

From time to time the Board have a need to consider privately placing its debt. Such placement shall be considered where the size is too small, the structure is too complicated for public debt issuance, the market of purchasers is limited, and/or will result in a cost savings to the Board relative to other methods of debt issuance.

## **Selection of Underwriting Team (Negotiated Transaction)**

If there is an underwriter, the Board shall require the underwriter to clearly identify itself in writing, whether in a response to a request for proposals (“RFP”) or in promotional materials provided to the Board or otherwise, as an underwriter and not as a financial advisor from the earliest stages of its relationship with the Board with respect to that issue. The underwriter must clarify its primary role as a purchaser of securities in an arm’s-length commercial transaction and that it has financial and other interests that differ from those of the Board. The underwriter in a publicly offered, negotiated sale shall be required to provide pricing information both as to interest rates and to takedown per maturity to the Board or its designated official in advance of the pricing of the debt.

### **A. Senior Manager**

The Board with assistance from its staff and financial advisor shall select the senior manager(s) for a proposed negotiated sale. The selection criteria shall include but not be limited to the following:

- Experience in selling Tennessee debt;
- Ability and experience in managing complex transactions;
- Prior knowledge and experience with the Board;
- Willingness to risk capital and demonstration of such risk;
- Quality and experience of personnel assigned to the Board's engagement;
- Financing ideas presented; and
- Underwriting fees.

### **B. Co-Managers**

Co-managers will be selected on the same basis as the senior manager. The number of co-managers appointed to specific transactions will be a function of transaction size and the necessity to ensure maximum distribution of the Board's bonds. The Secretary or Assistant Secretary to the Board will, at his or her discretion, affirmatively determine the designation policy for each bond issue.

### **C. Selling Groups**

The Board may use selling groups in certain transactions to maximize the distribution of bonds to retail investors. Firms eligible to be a member of the selling group, should either have a public finance department or pricing desk located within the boundaries of the State. To the extent that selling groups are used, the Secretary or Assistant Secretary of the Board at his or her discretion may make appointments to selling groups as the transaction dictates.

### **D. Underwriter's Counsel**

In any negotiated sale of the Board's debt in which legal counsel is required to represent the underwriter, the appointment will be made by the Senior Manager.

### **E. Underwriter's Discount**

The Board will evaluate the proposed underwriter's discount in comparison to other issues in the market. If there are multiple underwriters in the transaction, the Board will determine the allocation of fees with respect to the management fee, if any. The determination will be based upon participation in the structuring phase of the transaction. All fees and allocation of the management fee will be determined prior to the sale date. A cap on management fee, expenses and underwriter's counsel fee will be established and communicated to all parties by the Board. The senior manager shall submit an itemized list of expenses charged to members of the underwriting group. Any additional expenses must be substantiated.

### **F. Evaluation of Underwriter Performance**

The Board's staff, with assistance of the Financial Advisor, will evaluate each bond sale after completion to assess the following: costs of issuance including the underwriter's compensation, pricing of the bonds in terms of the overall interest cost and on a maturity-by-maturity basis, and the distribution of bonds and sales credit.

Following each sale, the Board's staff shall provide a report to the Board (including the information contained in the paragraph above) on the results of the sale.

## **Credit Quality**

The Board's debt management activities will be conducted to receive the highest credit ratings possible, consistent with Board's financing objectives. If the State's credit ratings are downgraded below the AAA rating, the capital funding and debt strategy will immediately be reviewed and necessary steps within the Board's authority taken to avoid additional downgrades and to restore the AAA rating.

The Office of the Comptroller of the Treasury through the OSLF will be responsible for the communication of information to the rating agencies and keeping them informed of significant developments throughout the year. The OSLF will schedule rating agency calls and/or visits prior to the issuance of General Obligation bonds.

The Board through the OSLF will engage the relevant rating agencies in advance, in the event that the Board decides to move forward with a plan of finance that includes variable rate debt, new commercial paper programs or the use of derivatives.

The Board shall apply for ratings from at least two of the three Statistical Rating Organizations (the "SRO"). The Board shall fully review the contract with the SRO and receive an engagement letter prior to submitting documentation for the rating.

## **Credit Enhancements**

The Board will consider the use of credit enhancements on a case-by-case basis, evaluating the economic benefit versus the cost. Only when clearly demonstrable savings can be shown shall an enhancement be utilized. The Board may consider each of the following enhancements as alternatives by evaluating the cost and benefit of such enhancements:

### **A. Bond Insurance**

The Board may purchase bond insurance when such purchase by the Board is deemed prudent and advantageous. The primary consideration shall be based on whether such insurance is less costly than the present value of the difference in the interest on insured bonds versus uninsured bonds. For competitive sales, the purchaser of the bonds may be allowed to determine whether bond insurance will be used and will be included in the bid for the bonds and will be paid for by the purchaser of the bonds. If the Board decides to purchase insurance, it shall do so on a competitive bid basis whenever practicable. In a negotiated sale, the Board will select a provider whose bid is most cost effective and will consider the credit quality of the insurer and that the terms and conditions governing the guarantee are satisfactory to the Board.

### **B. Letters of Credit**

The Board may enter into a letter-of-credit ("LOC") agreement when such an agreement is deemed prudent and advantageous. The Board will prepare and distribute an RFP to qualified banks or other qualified financial institutions which includes terms and conditions that are acceptable to the Board. The LOC will be awarded to the bank or financial institution providing the lowest cost bid with the highest credit quality that meets the criteria established by the State.

### **C. Liquidity**

For variable rate debt requiring liquidity facilities to protect against remarketing risk, the Board will evaluate:

- Alternative forms of liquidity, including direct pay letters of credit, standby letters of credit, and line of credit, in order to balance the protection offered against the economic costs associated with each alternative;
- Diversification among liquidity providers, thereby limiting exposure to any individual liquidity provider;
- All cost components attendant to the liquidity facility, including commitment fees, standby fees, draw fees, and interest rates charged against liquidity draws; and
- A comparative analysis and evaluation of the cost of external liquidity providers compared to the requirements for self-liquidity.

The winning bid will be awarded to the bank or financial institution providing the lowest cost with the highest credit quality that meets the criteria established by the State.

#### **D. Use of Structured Products**

No interest rate agreements or forward purchase agreements will be considered unless the Board has established a policy defining the use of such products before the transaction is considered.

### **Risk Assessment**

The OSLF will evaluate each transaction to assess the types and amounts of risk associated with that transaction, considering all available means to mitigate those risks. The OSLF will evaluate all proposed transactions for consistency with the objectives and constraints defined in this Policy. The following risks should be assessed before issuing debt:

#### **A. Change in Public/Private Use**

The change in the public/private use of a project that is funded by tax-exempt funds could potentially cause a bond issue to become taxable.

#### **B. Default Risk**

The risk that debt service payments cannot be made by the due date.

#### **C. Liquidity Risk**

The risk of having to pay a higher rate to the liquidity provider in the event of a failed remarketing of short term debt.

#### **D. Interest Rate Risk**

The risk that interest rates will rise, on a sustained basis, above levels that would have been set if the issue had been fixed.

#### **E. Rollover Risk**

The risk of the inability to obtain a suitable liquidity facility at an acceptable price to replace a facility upon termination or expiration of a contract period.

#### **F. Market Risk**

The risk that in the event of failed remarketing of short term debt, the liquidity provider fails.

## **Transparency**

The Board shall comply with the Tennessee Open Meetings Act, providing adequate public notice of meetings and specifying on the agenda when matters related to debt issuance will be considered. All costs (including interest, issuance, continuing, and one-time) shall be disclosed to the citizens in a timely manner. Additionally, the Board will provide certain financial information and operating data by specified dates, and provide notice of certain enumerated events with respect to the bonds continuing disclosure requirements as required by the U.S. Securities and Exchange Commission (“SEC”) Rule 15c2-12. The Board intends to maintain transparency by:

- Posting the Official Statement of a bond sale to the Board’s website within two weeks of the closing of such sale;
- Preparing and filing with the OSLF a copy of the costs related to the issuance of a bond and other information as required by Section 9-21-151, of the TCA, within 45 days of the closing of such sale, and presenting the original of such document to the Board at its next meeting (see also “Debt Administration – B. Post Sale”); and
- Electronically submitting through the Municipal Securities Rulemaking Board’s Electronic Municipal Market Access (“EMMA”) website the information necessary to satisfy the Board’s continuing disclosure requirements for the bonds in a timely matter (see also “Federal Regulatory Compliance and Continuing Disclosure”).

## **Professional Services**

The Board requires all professionals engaged to assist in the process of issuing debt to clearly disclose all compensation and consideration received related to services provided in the debt issuance process by the Board. This includes “soft” costs or compensations in lieu of direct payments.

### **A. Issuer’s Counsel**

The Board will enter into an engagement letter agreement with each lawyer or law firm representing the Board in a debt transaction. No engagement letter is required for any lawyer who is an employee of the Office of Attorney General and Reporter for the State of Tennessee who serves as counsel to the Board or of the Office of General Counsel, Office of the Comptroller of the Treasury, which serves as counsel to the OSLF regarding Board matters.

### **B. Bond Counsel**

Bond counsel shall be engaged through the OSLF and serves to assist the Board in all its general obligation debt issues under a written agreement.

### **C. Financial Advisor**

The Financial Advisor shall be engaged through the OSLF and serves and assists the Board on financial matters under a written agreement. However, the Financial Advisor shall not be permitted to bid on, privately place or underwrite an issue for which it is or has been providing advisory services. The Financial Advisor has a fiduciary duty including a duty of loyalty and a duty of care.

### **D. Dealer**

The Board will enter into a Dealer Agreement with the appointed CP dealer. The Dealer agrees to offer and sell the CP, on behalf of the Board, to investors and other entities and individuals who would normally purchase commercial paper.



## **E. Issuing and Paying Agent**

The Board covenants to maintain and provide an Issuing and Paying Agent at all times while the CP is outstanding. The Board will enter into an Issuing and Paying Agency Agreement with an appointed firm. The Issuing and Paying Agent will be a bank, trust company or national banking association that has trust powers.

## **F. Credit/Liquidity Provider**

The Board shall enter into a Credit/Liquidity Agreement with an appointed provider if deemed necessary or advisable for the CP. The provider shall be a bank, lending institution or the Tennessee Consolidated Retirement System (“TCRS”) that extends credit to the Board in the form of a revolving credit facility, a line of credit, a loan or a similar credit product or as a liquidity facility for CP.

## **G. Refunding Trustee**

The Refunding Trustee shall be appointed by resolution of the Board adopted prior to the issuance of any refunding bonds. The Refunding Trustee will be a bank, trust company or national banking association that provides Paying Agent or Registrar services.

## **Potential Conflicts of Interest**

Professionals involved in a debt transaction hired or compensated by the Board shall be required to disclose to the Board existing client and business relationships between and among the professionals to a transaction (including but not limited to financial advisor, swap advisor, bond counsel, swap counsel, trustee, paying agent, underwriter, counterparty, and remarketing agent), as well as conduit issuers, sponsoring organizations and program administrators and other issuers whom they may serve. This disclosure shall include such information that is reasonably sufficient to allow the Board to appreciate the significance of the relationships.

Professionals who become involved in a debt transaction as a result of a bid submitted in a widely and publicly advertised competitive sale conducted using an industry standard, electronic bidding platform are not subject to this disclosure provision. No disclosure is required if such disclosure would violate any rule or regulation of professional conduct.

## **Debt Administration**

### **A. Planning for Sale**

- Prior to submitting a bond resolution for approval, the Director of the OSLF (the “Director”), with the assistance of the Financial Advisor, will present to staff of the members of the Board information concerning the purpose of the financing, the estimated amount of financing, the proposed structure of the financing, the proposed method of sale for the financing, members of the proposed financing team, and an estimate of all the costs associated with the financing, and;
- In addition, in the case of a proposed refunding, proposed use of credit enhancement, or proposed use of variable rate debt, the Director will present the rationale for using the proposed debt structure, an estimate of the expected savings associated with the transaction and a discussion of the potential risks associated with the proposed structure.
- The Director (with the assistance of staff in the OSLF), Bond Counsel, Financial Advisor, along with other members of the financing team will prepare a Preliminary Official Statement describing the transaction and the security for the debt that is fully compliant with all legal requirements.

## **B. Post Sale**

- The Director (with the assistance of staff in the OSLF), Bond Counsel, and Financial Advisor, along with other members of the financing team will prepare an Official Statement describing the transaction and the security for the debt that is fully compliant with all legal requirements.
- The Financial Advisor will provide a closing memorandum with written instructions on transfer and flow of funds.
- The Director will present a post-sale report to the members of the Board describing the transaction and setting forth all the costs associated with the transaction.
- Within 45 days from closing, the Director will prepare a Form CT-0253 - "Report on Debt Obligation" outlining costs related to the issuance and other information set forth in Section 9-21-151, of the TCA, and also present the original at the next meeting of the Board, and file a copy with the OSLF.
- The Director will establish guidelines and procedures for tracking the flow of all bond proceeds, as defined by the Internal Revenue Code, over the life of bonds reporting to the Internal Revenue Service (IRS) all arbitrage earnings associated with the financing and any tax liability that may be owed.
- The Post-Issuance Compliance ("PIC") team will meet annually to review matters related to compliance and complete the PIC checklist.
- As a part of the PIC procedures, the Director (with the assistance of staff in the OSLF) will, no less than annually, request confirmation from the responsible departments that there has been no change in use of tax-exempt financed facilities.

## **Federal Regulatory Compliance and Continuing Disclosure**

### **A. Arbitrage**

The OSLF will comply with arbitrage requirements on invested tax-exempt bond funds. Proceeds that are to be used to finance construction expenditures are exempted from the filing requirements, provided that the proceeds are spent in accordance with requirements established by the IRS. The Board will comply with all of its tax certificates for tax-exempt financings by monitoring the arbitrage earnings on bond proceeds on an interim basis and by rebating all positive arbitrage when due, pursuant to Internal Revenue Code, Section 148. The Board currently contracts with an arbitrage consultant to prepare these calculations, when needed. The Board will also retain all records relating to debt transactions for as long as the debt is outstanding, plus three years after the final redemption date of the transaction.

### **B. Investment of Proceeds**

Any proceeds or other funds available for investment by the Board must be invested per Section 9-9-110 of the TCA, subject to any restrictions required pursuant to any applicable bond issuance authorization. Compliance with Federal tax code arbitrage requirements relating to invested tax-exempt bond funds will be maintained.

Proceeds used to refinance outstanding long-term debt shall be placed in an irrevocable refunding trust fund with a Refunding Trustee. The investments (i) shall not include mutual funds or unit investments trusts holding such obligations, (ii) are rated not lower than the second highest rating category of both Moody's Investors Service, Inc. and Standard and Poor's Global rating services and (iii) shall mature and bear interest at such times and such amounts as will be sufficient without

reinvestment, together with any cash on deposit, to redeem the bonds to be refunded and to pay all interest coming due on the bonds to be refunded.

### **C. Disclosure**

The Board will disclose on EMMA the State's audited Comprehensive Annual Financial Report as well as certain financial information and operating data required by the continuing disclosure undertakings for the outstanding bonds no later than January 31<sup>st</sup> of each year. The Board will timely disclose any failure to provide required annual financial information by January 31<sup>st</sup>. The Board will also, in accordance with the continuing disclosure undertakings, disclose on EMMA within ten business days after the occurrence of any of the following events relating to the bonds to which the continuing disclosure undertakings apply:

- Principal and interest payment delinquencies
- Nonpayment-related defaults, if material
- Unscheduled draws on debt service reserves reflecting financial difficulties
- Unscheduled draws on credit enhancements reflecting financial difficulties
- Substitution of credit or liquidity providers or their failure to perform
- Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notice of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of such bonds or other material events affecting the tax status of such bonds
- Modifications to rights of bond holders, if material
- Bond calls, if material, and tender offers
- Defeasances
- Release, substitution or sale of property securing the repayment of the bonds, if material
- Rating changes
- Bankruptcy, insolvency, receivership, or similar event of the State
- Consummation of a merger, consolidation, or acquisition of the issuer or sale of all or substantially all of the assets of the Board, other than in the course of ordinary business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material
- Appointment of successor trustee or the change of name of a trustee, if material

### **D. Generally Accepted Accounting Principles (GAAP)**

The Board will comply and prepare its financial reports in accordance with the standard accounting practices adopted by the Governmental Accounting Standards Board and with the accounting policies established by the department of finance and administration when applicable.

## **Review of the Policy**

The debt policy guidelines outlined herein are only intended to provide general direction regarding the future use and execution of debt. The Board maintains the right to modify these guidelines and may make exceptions to any of them at any time to the extent that the execution of such debt achieve the Board's goals.

This policy will be reviewed by the Board no less frequently than annually. At that time, the Director will present any recommendations for any amendments, deletions, additions, improvement or clarification.


## **Adoption of the Policy**

After a public hearing on August 24, 2011, the Board adopted the Policy on September 8, 2011, effective September 8, 2011.

After a public hearing on September 16, 2013, the Board adopted the amended Policy on September 16, 2013, effective September 16, 2013.

After a public hearing on May 11, 2017, the Board adopted the amended Policy on May 11, 2017, effective May 11, 2017.

After a public hearing on March 2, 2018, the Board adopted the amended Policy on March 2, 2018, effective March 2, 2018.

  
Secretary  
Tennessee State Funding Board

**ANNUAL REVIEW**

The Board has reviewed and accepted the Debt Management Policy on:

October 8, 2014

November 19, 2015